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EXECUTIVE SECRETARIAT

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Executive Secretary

6/17/83

Date

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CABINET AFFAIRS STAFFING MEMORANDUM

DATE: 6/15/83 NUMBER: ----------- DUE BY: -----------

SUBJECT: Cabinet Council on Economic Affairs Minutes

	ACTION	FYI
ALL CABINET MEMBERS	☐	☑
Vice President	☐	☐
State	☐	☐
Treasury	☐	☐
Defense	☐	☐
Attorney General	☐	☐
Interior	☐	☐
Agriculture	☐	☐
Commerce	☐	☐
Labor	☐	☐
HHS	☐	☐
HUD	☐	☐
Transportation	☐	☐
Energy	☐	☐
Education	☐	☐
Counsellor	☐	☐
OMB	☐	☐
CIA	☐	☐
UN	☐	☐
USTR	☐	☐
CEA	☐	☑
CEQ	☐	☐
OSTP	☐	☐
	☐	☐
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	ACTION	FYI
Baker	☐	☑
Deaver	☐	☐
Clark	☐	☑
Darman *(For WH Staffing)*	☑	☐
Harper	☐	☑
Jenkins	☐	☑
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CCCT/Gunn	☐	☑
CCEA/Porter	☐	☑
CCFA/Boggs	☐	☑
CCHR/Carleson	☐	☑
CCLP/Uhlmann	☐	☑
CCMA/Bledsoe	☐	☑
CCNRE/Boggs	☐	☐

REMARKS:

Attached for your information are the following Cabinet Council on Economic Affairs minutes:

May 12, 1983
May 19, 1983
May 26, 1983
June 7, 1983
June 9, 1983

RETURN TO:

☐ Craig L. Fuller
Assistant to the President
for Cabinet Affairs
456-2823

☑ Becky Norton Dunlop
Director, Office of
Cabinet Affairs
456-2800

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MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

May 12, 1983
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Block, Donovan, Harper, Feldstein, Chapoton, Dederick, Knapp, Naylor, Baroody, Burnley, Cicconi, Denend, Franklin, Platt, Vipond, and McAllister, Ms. Dunlop, and Ms. Risque.

Secretary Regan began the meeting by noting that in his recent discussions with foreign finance ministers, they all urged that the United States reduce its Federal budget deficit and interest rates.

1. Expansion of Spousal IRAs

Mr. Chapoton reported on a proposal to increase the "Spousal IRA" contribution to $4,000. Under the Economic Recovery Tax Act of 1981 (ERTA), IRA contributions were expanded to $2,000 for each working person, or $4,000 for a working couple, and $2,250 for a couple with a non-working spouse, a "Spousal IRA".

Mr. Chapoton stated that there are good arguments both supporting and opposing expansion. The fact that there is only one wage earner does not diminish the need for retirement savings. However, the tax revenue loss would increase from an estimated $135 million in 1984 to an estimated $522 million in 1988.

The Council discussed the impact of the proposed expansion on savings. It was noted that the expansion from $2,250 to $4,000 would have a stronger effect on new savings per tax revenue dollar lost than the initial $2,250. There were questions regarding how much of recent IRA contributions have been new savings, and how much has been borrowed. Mr. Chapoton observed that it is too early to identify the sources of the IRA contributions and how much is new savings.

Several members of the Council questioned whether most families with a non-working spouse would be able to benefit from the proposed expansion. It was felt that those most likely to benefit would be upper income families, and that this involved a question of fairness. Mr. Chapoton pointed out that the Department of the Treasury has estimated that 25 percent of the tax savings would be realized by families with adjusted gross incomes of $30,000 and less, and 69 percent by families with adjusted gross incomes of $30,000 to $100,000.

Ms. Risque reported that a group of Republican Congresswomen had raised the IRA expansion issue. Many individuals do not understand that the IRA of a non-working spouse is not limited to $250. The current law simply provides that the combined IRAs of a worker and non-working spouse cannot exceed $2,250 of annual contributions.

Secretary Regan requested that Treasury prepare a one page fact sheet on equity in the current IRA law for the May 18 meeting with the President on women's issues. He asked that the paper note the significant tax changes beneficial to women made by the Reagan Administration.

2. Tax Credit for Dependent Care

Mr. Chapoton reported on a provision of the Economic Equity Act of 1983 and H.R. 2090 (Rep. Conable) that would increase the tax credit allowed for dependent care expenditures. The Economic Recovery Tax Act of 1981 (ERTA) changed the way tax credits are calculated, raising the ceiling slightly and introducing a sliding scale based on income. The proposed increase in the credit would alter the sliding scale to raise the credit for low-income taxpayers.

Mr. Chapoton pointed out that under the proposal a family with an adjusted gross income of $12,000 would receive a tax credit of $1,100 but their tax liability would only be roughly $700. Since the credit would not be refundable the proposed increase in the credit would not have an effect on low-income taxpayers.

Ms. Risque stated that the increase in the tax credit was proposed by a group Republican Congresswomen, who perhaps were not aware that ERTA had already instituted a sliding scale.

Secretary Regan asked that a one-half page fact sheet on the proposed tax credit increase be prepared for the women's issues meeting with the President. The paper should note the Administration's commitment to the tax principle of non-refundability.

3. Farmers Home Administration

Mr. Naylor reported to the Council on the status of Farmers Home Administration (FmHA) lending. Much of the recent bad publicity is a consequence of the unrestrained expansion during the Carter Administration both in the volume of loans (from $7.2 billion in 1976 to $13 billion in 1980) and in the number of new borrowers assisted without a commensurate increase in supervision of the loans or management of the expanding loan portfolio. In addition, the extremely aggressive use of both the agency's natural disaster program and the FY 1978 implementation of a new economic emergency program resulted in billions of dollars of commitments and, in many cases, unsound loans. Over the last two years the delinquency rate for the base FmHA programs has been relatively stable. The rate for the emergency programs has tripled.

Mr. Naylor stated that to date the Administration has successfully resisted reimplementing the Economic Emergency Lending Program and four separate efforts to enact moratorium-deferral legislation. The abuse of emergency lending authorities has been substantially curtailed through close oversight and tightened regulation. The business and industrial loan program is scheduled for termination in FY 1984.

Mr. Naylor reported that the House of Representatives has passed an agricultural credit assistance bill that would increase on-and off-budget spending by $17 to $18 billion, restore the Economic Emergency Lending Program, and impose a moratorium on FmHA foreclosures. The Senate will soon consider similar legislation.

Secretary Block pointed out that responsible farm groups, such as the American Farm Bureau Federation, opposed the credit bailout. He observed that FmHA lending represented only 12 percent of all farm lending and that 50 percent of all farmers do not have any debt.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

May 19, 1983
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Donovan, Harper, Dederick, Kudlow, Lighthizer, Mossinghoff, Poole, Porter, Sprinkel, Rhodes, Williamson, Franklin, Robinson, Cicconi, and McAllister, and Ms. Dunlop.

1. Financial Market Developments and Monetary Policy

Mr. Kudlow reported to the Council that recent economic news suggests a stronger first year recovery rate than expected only a month ago, probably closer to 6 percent than the earlier 4 percent consensus estimate. Industrial production increased 2.1 percent in April and the cumulative 5.5 percent rise since December is larger than the average gain during the first four months of the postwar recoveries. Total payroll employment is running ahead of the postwar average, 0.73 percent vs. 0.61 percent above the trough of four months earlier. Unfilled orders for durable goods (a leading indicator of production) have increased 2.0 percent since December compared to 0.2 percent for the comparable recovery average.

Mr. Kudlow stated that although money growth has slowed recently, the evidence of a more restrained policy is not yet convincing. The money growth rate is still outside the target range, and would require a growth rate of 6.8 percent over the rest of the year to conform to the 8 percent upper bound of the money target, and 2.6 percent growth to achieve the 6 percent lower bound.

Mr. Kudlow pointed out that short and long-term interest rates declined by about 25-35 basis points in April, but during the past two weeks have returned to where they were a month ago. There is a great deal of uncertainty about the future of interest rates. With rising profits and personal income, the economy is still in the reliquification stage of the business cycle. This should generate lower not higher interest rates. Fiscal and monetary policies however have a far greater impact on interest rates than the business cycle.

Mr. Poole briefed the Council on the Federal Reserve's monetary control procedures. In the 1970's, the Fed's operating procedure was to establish a monetary target, estimate the money demand function, and then attempt to control an interest rate, the federal funds rate, consistent with both the money demand function and the desired money stock. If the money demand function shifted unexpectedly, the money stock growth rate would exceed or fall short of the desired target.

Mr. Poole claimed that in the summer of 1982 the Federal Reserve appeared to abandon its October 1979 monetary control reforms and returned to the previous practice of targeting interest rates. With this system it is not possible for the Fed to precisely control money growth over periods of several months and even quarters. Thus there is no guarantee that money growth will not continue to surge, or will not fall to an excessively low rate, for a period of several months or longer.

Mr. Sprinkel's presentation focused on the near-term outlook for monetary policy and interest rates. From July 1982 to March 1983, M1 grew at a 15 percent annual rate. In April, M1 declined at a 3.1 percent rate. Growth of adjusted bank reserves and the adjusted monetary base has also decelerated in the last 6-8 weeks foreshadowing a continuous gradual slowing of money growth. A continuing deceleration of money growth to a moderate rate could further improve the outlook in the financial markets and provide for additional declines in interest rates. The markets have no assurance, however, that the Fed will succeed in moderating money growth and are likely to remain extremely sensitive to any signs of continued rapid money growth.

Mr. Sprinkel stated that in his view the Fed should moderate the 15 percent M1 growth that occurred in the first quarter of 1983, without reducing it so rapidly as to jeopardize the recovery. It was pointed out that the recent growth in the money supply cannot be attributed to financial deregulation; reserve and monetary base growth have also been very high.

Mr. Sprinkel also pointed out that the Federal Reserve is basing policy on the presumption that velocity has fallen. It is not clear if the recent decline in velocity is permanent or transitory. There are reasons to believe that the decline is only transitory, for instance velocity typically declines during a recession.

The Council discussion centered about the prospects for interest rates and the recovery. Members generally agreed that there is no reason why interest rates cannot come down further; the key is fiscal and monetary policies. The Federal Reserve cannot force or lead rates lower by pushing the federal funds rate down. It was emphasized that the deficit problem should not be exacerbated by an accomodative monetary policy, which would reignite inflationary expectations.

2. Economic Conditions of State and Local Governments

Mr. Dederick presented a brief analysis of the potential effects of changes in Federal aid on municipal and State governments. Large cities are probably more sensitive than small ones to Federal spending reductions because they are consistently more dependent on intergovernmental aid and because they devote larger shares of their budgets to the kinds of programs that would be heavily affected by reductions in Federal aid.

Mr. Dederick pointed out that large cities also have more elastic revenue sources than small cities. With a vigorous recovery it is likely that these cities can manage the reductions. A short-lived or shallow recovery would be more difficult, particularly in distressed regions.

Mr. Dederick also reported that thirteen states receive more than 30 percent or more of their revenue from the Federal Government. In the West much of the assistance is used for highways; in the South and Northeast, the assistance is used predominantly for welfare and education spending. The states are responding to the changed fiscal outlook; 35 states have reduced spending below the levels originally set for FY 1983; and 43 states are considering tax legislation that would raise an additional $12 billion. However, one area particularly vulnerable to state spending reductions is aid to local governments.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

May 26, 1983
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Smith, Stockman, Harper, Feldstein, Hovde, Mossinghoff, Chapoton, Ford, Keel, Nau, Porter, Rhodes, Sprinkel, Wallis, Cicconi, Neal, and McAllister, Ms. Dunlop and Ms. Risque.

1. Williamsburg Economic Summit Briefing

Mr. Wallis continued the briefing begun at the May 24 Cabinet Council meeting. He reported that the major substantive issues likely to be addressed at the Williamsburg Economic Summit are: (1) The high level of U.S. interest rates, deficits, and exchange rates. The U.S. position is that we are seeking to reduce our interest rates and deficits and that these factors have an even greater adverse effect on the U.S. economy than on the other summit countries' economies. (2) The need to reduce protectionist trade barriers. The OECD has called for a progressive dismantling of trade barriers. The U.S. would like to extend the GATT to cover services. (3) The need for an international financial arrangement, similar to the defunct Bretton Woods Agreement. The U.S. position is that exchange rate instability is a symptom, not a cause, of differences in economic policies and performance. (4) Multilateral surveillance.

Mr. Sprinkel explained that multilateral surveillance refers to a commitment made at the Versailles Summit by the major industrial countries for: (1) convergence in domestic economic policies toward sustainable non-inflationary growth of real income and employment, and away from stop-go policies; and (2) improvement in the process for discussion of policies designed to narrow differences in economic conditions. The IMF issues periodic assessments of each country's policy performance.

Mr. Wallis pointed out that Canada and France might suggest the need for more financial assistance to less developed countries (LDC's). The U.S. position is that governments of the LDC's must adopt sound fiscal and monetary policies that will help create a healthy environment to attract foreign investment. Moreover, developed nations must remove trade barriers to imports from the LDC's. Many of the protected industries in the developed countries are those that offer the most potential for LDC exports.

Mr. Nau observed that the Reagan Administration has shifted the composition of U.S. foreign assistance in favor of the poorer LDC's. Mr. Sprinkel noted that the U.S. has had some success in influencing the multilateral development banks to require recipient countries to adopt sound fiscal and monetary policies.

2. Report of the Working Group on R&D Tax Policy

The Treasury is scheduled to testify at a May 27 Senate Finance Subcommittee on Taxation and Debt Management hearing on bills relating to tax incentives for research and development. Mr. Chapoton sought Cabinet Council guidance on the testimony.

Mr. Chapoton reported that S. 738 would remove the December 31, 1985 "sunset" date from the tax credit for incremental R&D expenditures, which was created by the Economic Recovery Tax Act of 1981 (ERTA). He proposed that Treasury's testimony state the Administration strongly supports the objective of the credit but that more complete information about the effectiveness and efficiency of the credit is needed before a decision can be made to extend it beyond 1985.

Mr. Chapoton pointed out that practically and conceptually it is difficult to define what is an R&D expense. He also observed that the purpose of the credit is to encourage R&D spending that would not otherwise occur.

The Council discussion focused on several questions, including whether the credit has encouraged additional R&D expenditures. Anecdotal evidence suggesting that it might was offered. Several members pointed out that R&D spending is a long-term investment and that clear cut evidence might not be available yet.

The Council instructed Mr. Chapoton to report that the Administration: (1) seeks a minimum three-year extension of the sunset provision; and (2) desires to work with the Committee on the problem of defining R&D. The Working Group is to report back to the Cabinet Council on the progress of its discussions with the Senate Finance Committee.

Mr. Chapoton also requested the Council's view on S. 1194 and S. 1195, which would allow corporations larger deductions for contributions of computers and "qualified services" to primary and secondary schools. Under the bills, the tax deduction could exceed the donor's cost of the equipment.

Several members of the Council observed that S. 1194 and 1195 are similar in intent to the "Apple Computer" bill, which the Administration supported last year. Mr. Chapoton stated that the "Apple Computer" bill was limited to one year, not the five years proposed in S. 1194 and S. 1195, was more narrowly targeted and had an estimated revenue cost of roughly one-tenth the present proposal. Mr. Regan noted that the bills would provide dissimilar treatment of voluntary contributions; donations of computers would receive greater tax benefits than other kinds of donations.

The Council accepted the proposed Treasury statement that deductions for gifts and services should be limited to their cost.

Mr. Chapoton also reported on S. 654, which would prevent the Treasury from implementing a regulation allocating R&D expenses between domestic and foreign source income. The previous regulation was suspended by ERTA for two years, allowing firms to allocate R&D solely to domestic income. The Congress through ERTA, also required Treasury to study and report on the impact of the regulation.

Mr. Chapoton stated that the Treasury report, which is completed and awaiting release, indicates that had the regulations been in effect in 1982, U.S. tax liabilities of U.S. firms would have been $100 million to $240 million higher. Domestic R&D would have been reduced by about $40 million to $260 million. Mr. Chapoton observed that the benefits of the suspension do not necessarily accrue to high tech industries.

The Council decided that Treasury should release its report while indicating that the Administration believes the moratorium should continue.

3. <u>Housing and Depository Institution Outlook</u>

Mr. Hovde provided a brief update on the status of the housing market and depository institutions: home prices are up only 2.7 percent over a year ago, and in April did not increase at all; the mortgage delinquency rate is declining; the majority of saving and loans are now profitable; and FHA participation rates are down from the 26 percent of last December to the more typical 14 percent level.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

June 7, 1983
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Brock, Stockman, Feldstein, Darman, Thayer, Verstandig, Porter, Knapp, Wright, Naylor, McCormack, Angrisani, Burnley, Dederick, Cicconi, Franklin, Skancke, Platt, and Denend, Ms. Risque and Ms. Dunlop.

1. Budget Outlook

The Council reviewed a paper prepared by David Stockman on the outlook for the Federal budget for fiscal years 1984 through 1988. Because of the sensitivity of the material presented in the paper, all copies were collected and returned to OMB at the end of the meeting.

Mr. Stockman's presentation concluded that using current economic assumptions and enacted or probable spending, revenue, and interest savings, produces annual deficits near the $200 billion level through 1988. By using assumptions based on a high growth recovery -- assumptions which are likely to exceed the expected recovery -- deficits are reduced approximately 10 percent per year.

Mr. Stockman emphasized that the range of policy actions affecting spending and receipts have a much greater effect on the deficit than does a high growth recovery. The potential impact on deficit levels is more than five times as great resulting from possible policy actions than the effect of a high growth recovery.

The Council discussed the feasibility of achieving the policy savings included in the OMB analysis. For a number of reasons, actual deficits could be expected to be somewhat higher than those projected by OMB. The Council also discussed the question of whether the Administration should undertake a review of alternative fiscal strategies. No decision was made to proceed with any additional fiscal policy review.

Several members of the Council suggested that a Council Working Group should review the method used to determine a high employment deficit. Although some expressed the view that the only useful calculation is the current deficit based on the most likely policy and economic assumptions, the Executive Secretary agreed to consider the suggestion of such a review.

2. Report of the National Productivity Advisory Committee

The Council reviewed two papers. The first presented the National Productivity Advisory Committee recommendation to waive the nonimmigrant visa requirement for certain countries for an experimental period. The second outlined plans for the White House Conference on Productivity.

The Council supported a recommendation of the National Productivity Advisory Committee presented by Mr. Porter, to waive the nonimmigrant visa requirement for nationals of up to eight countries for an experimental three year period. The waiver would apply to visitors intending to stay no longer than 90 days in the U.S. and who possess nonrefundable return airline tickets. The Council noted that the State Department is currently attempting to make this recommendation a provision of pending immigration legislation.

Mr. Porter briefed the Council on plans for the White House Conference on Productivity scheduled for September 22-23 in Washington. Four preparatory conferences have been scheduled during June, July, August at the following locations:

June 14-16	Capital Formation	Durham, North Carolina
June 21-23	Human Resources	St. Louis, Missouri
June 19-21	Role of Government	San Diego, California
August 2-4	Private Sector Initiatives	Pittsburgh, Pennsylvania

Mr. Porter noted that the preparatory meetings have been structured to provide balanced participation of all interested parties. The National Productivity Advisory Committee has focused to date in its recommendations on public policy changes to improve productivity; the White House Conference will also focus attention on measures the private sector can take.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

June 9, 1983
3:00 p.m.
Roosevelt Room

Attendees: Messrs. Regan, Hodel, Stockman, Harper, Darman, Porter, Chapman, Dederick, Ford, Knapp, Poole, Smith, Sprinkel, Neal, Platt, Weiss, and McAllister; Ms. Dunlop, Ms. Norwood, and Ms. Risque.

1. <u>Financial Market Developments and Monetary Policy</u>

The Council reviewed papers prepared by Under Secretary of Commerce Robert Dederick, William Poole, and Under Secretary of the Treasury Beryl Sprinkel on recent economic developments and the course of monetary policy.

Under Secretary Dederick reported that in his view the recovery has become stronger and broader. Real GNP growth for this quarter will probably be at least 6 percent and could very well reach 8 percent. Non-farm payroll employment increased by 796,000 from December to May. Industrial production grew at a 17 percent annual rate over the same period. Retail sales increased 1.7 percent in March and 1.6 percent in April. In May, consumer confidence, as measured by the University of Michigan consumer sentiment index, reached its highest level since the third quarter of 1972.

Mr. Dederick stated that although the period of a stable consumer price index appears to have ended, inflation remains under control, and should be in the range of 4 to 5 percent for the rest of 1983.

He suggested that the July 1 tax rate cut, the low level of inventories, the increase in consumer wealth generated by the rising stock market and higher home values, and the accommodative monetary policy portend a continued strong recovery.

Mr. Poole pointed out that the recent money supply increases correspond with rising interest rates and rising exchange rates. In May the Treasury bill rate was about 8.0 percent and the 30-year Government bond yield was about 10.35 percent. Today those rates are about 8.8 percent and 11.0 percent, respectively. His interpretation is that the increases in interest rates are anticipatory; the market expects the Federal Reserve to tighten the growth of money after each of the money supply surges. Exchange rates are rising because the real rate of interest is expected to increase as the Federal Reserve restrains monetary growth and interest rates rise.

Mr. Poole stated that in his opinion M1 is the most reliable measure of the money stock at this time. During the recent recession M1 was the only major monetary aggregate to exhibit a pronounced deceleration. Moreover, the acceleration of M1 growth starting in August 1982 was followed by a business expansion starting in January 1983, in line with the U.S. historical experience of a six to nine month lag in business activity changes following major changes in the rate of money growth.

Mr. Poole believes that despite the recent interest rate increases, underlying monetary conditions are quite favorable. The financial community remains confident that the inflationary mistakes of the 1970's will not be repeated. He suggested that the Administration should at some point be willing to accept temporary interest rate increases if needed to control money growth.

Under Secretary Sprinkel stated that in his view the 14 percent growth rate of M1 over the last nine months is not necessary for a strong recovery. The 1975-76 recovery offers evidence that while maintaining monetary growth at a non-inflationary rate during a recovery may lead to a temporary increase in interest rates, it does not prevent real economic growth.

Mr. Sprinkel warned that the potential inflationary effect of the recent money stock increases may be exacerbated if velocity increases, as it typically does during a recovery. He also suggested that a sudden and dramatic decline in the growth of money could adversely affect output and employment.

The Council discussed the concept of velocity; how it is measured; how the growth of money affects velocity; and how long it takes velocity to respond to changes in business activity and changes in the money supply.

Several members of the Council asked if factors other than changes in the money stock could have prompted the recent increases in interest rates. Mr. Dederick pointed out that interest rates respond to a number of factors, including the demand for credit. But he believed that the recent interest rate increases are attributable to the increases in the money supply.

2. <u>Report of the Working Group on Economic Statistics</u>

The Council did not have time to discuss the report of the Working Group on Economic Statistics on draft statistical confidentiality legislation. It will be taken up at a subsequent Cabinet Council meeting.

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